

## PAPER – 6 : AUDITING AND ASSURANCE

*Question No.1 is compulsory.*

*Attempt any **five** questions from the remaining six questions.*

### Question 1

*Discuss the following:*

- (a) *What are the circumstances that may result in other than an unqualified opinion on the Financial Statements by an auditor?* **(5 Marks)**
- (b) *Securities premium can be utilized only for certain purposes laid down in the Companies Act, 2013.* **(5 Marks)**
- (c) *Clarification on the Auditor's rights where clients and other Auditors seek access to their audit working papers.* **(5 Marks)**
- (d) *In the context of SA 560 "Subsequent events", state specific enquiries on matters by an auditor which may have effect on Financial Statements.* **(5 Marks)**

### Answer

#### (a) Circumstances That May Result in Other Than an Unqualified Opinion

**Limitation on Scope:** If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management to remove the limitation

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedure to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
  - (i) Resign from the audit, where practicable and not prohibited by law or regulation; or

- (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements

If the auditor resigns as contemplated by the above paragraph, before resigning, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion

**Disagreement with Management:** The auditor may disagree with management about matters such as the acceptability of the accounting policies selected the method of their application, or the adequacy of disclosures in the financial statements. If such disagreements are material to the financial statements, the auditor shall express a qualified or an adverse opinion

**Other considerations relating to an Adverse Opinion or Disclaimer of Opinion**

When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

- (b) **Utilisation of Share Premium:** Section 52(1) requires creation of Securities Premium Account and states that the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the premium account was paid-up share capital of the company. Section 52(2) lays down that the securities premium account may be applied by the company-
  - (i) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;
  - (ii) in writing off the preliminary expenses of the company;
  - (iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
  - (iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
  - (v) for the purchase of its own shares or other securities under Section 68.

Thus, it is clear from the above that share premium can be utilised only for specific purposes.

**(c) Clarification on the Auditors' Rights where Clients and Other Auditors seek access to their Audit Working Papers:**

- (1) The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose. SA 230 on "Audit Documentation" provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.
- (2) Clause 1 Part I of the Second Schedule to the Chartered Accountants Act, 1949, provides that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by any law for the time being in force.
- (3) Requests are sometime received by the members of the Institute, who have/had been performing the duties as the auditors of an enterprise, to provide access to their audit working papers. The requests may be made by the clients or other auditors of the enterprise or its related enterprise such as a parent enterprise.
- (4) It is hereby clarified that except to the extent stated in para 5 below, an auditor is not required to provide the client or the other auditors of the same enterprise or its related enterprise such as a parent or a subsidiary, access to his audit working papers. The main auditors of an enterprise do not have right of access to the audit working papers of the branch auditors. In the case of a company, the statutory auditor has to consider the report of the branch auditor and has a right to seek clarifications and/or to visit the branch if he deems it necessary to do so for the performance of the duties as auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of the other auditor. For this purpose, the term 'auditor' includes 'internal auditor'.
- (5) As stated in Para 4 above, the client does not have a right to access the working papers of the auditor. However, the auditor may, at his discretion, in cases considered appropriate by him, make portions of or extracts from his working papers available to the client.

**(d) Inquiring from Management to Evaluate Subsequent Event:** As per SA 560 "Subsequent Events", in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matter.

- (i) Whether new commitments, borrowings or guarantees have been entered into.
- (ii) Whether sales or acquisitions of assets have occurred or are planned.
- (iii) Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- (iv) Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
- (v) Whether there have been any developments regarding contingencies.
- (vi) Whether any unusual accounting adjustments have been made or are contemplated.
- (vii) Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
- (viii) Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
- (ix) Whether any events have occurred that are relevant to the recoverability of assets.

**Question 2**

*State with reasons (in short) whether the following statements are correct or incorrect: (Answer any **eight**)*

- (a) *The basic objective of audit does not change with reference to nature, size or form of an entity.*
- (b) *Depreciation is charged by the company on purchase of stand-by depreciable assets which are ready to use.*
- (c) *Casual vacancy of a 'Cost Auditor of a Company is filled by shareholders in general meeting within one month.*
- (d) *Board of Directors can contribute to any charitable and other funds any amount in a financial year.*
- (e) *The Managing Director of a company has shifted company's books of accounts from Registered office (Mumbai) to Corporate Office (New Delhi).*
- (f) *Vouching of payments is merely check proof that money has been paid.*
- (g) *Engagement letter need not be entered for each year of the period of auditor's appointment.*
- (h) *There is no relation between Inherent risk, Control risk and Detection risk.*

- (i) *Written representation can be a substitute for other audit evidence.*
- (j) *Negative balance of 'Reserves & Surplus' is shown on the Assets side of Balance Sheet.*

**(8 x 2 = 16 Marks)**

**Answer**

- (a) **Correct:** An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.
- (b) **Correct:** As per AS 10 (Revised) property, plant and equipment, depreciation of an asset begins when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Therefore, depreciation charged by the company on purchase of stand-by assets which are ready to use is correct.
- (c) **Incorrect:** Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within 30 days of such appointment of cost auditor.
- (d) **Incorrect:** Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed 5% of its average net profits for the three immediately preceding financial years.
- (e) **Incorrect:** As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible, however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within 7 days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.
- (f) **Incorrect:** Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of assertions in regard to transactions recorded in the books of account.
- (g) **Incorrect:** An engagement letter may need to be entered into for each year of the period covered by the eligibility letter issued by the auditor under Section 139 of the companies act 2013 and the appointment letter received from the company, to supplement - update

for any subsequent changes. This may be required because the appointment would need to be ratified at each AGM under section 139 of the said Act.

- (h) **Incorrect:** There is an inverse relationship between detection risks and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.
- (i) **Incorrect:** One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.
- (j) **Incorrect:** Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

### Question 3

*How will you Vouch/Verify the following?*

- (a) *Expenditure incurred for promotion of a product.*
- (b) *Inventories - Work-in-progress.*
- (c) *Purchase returns.*
- (d) *Discounted Bills receivable dishonoured.*

**(4 x 4 = 16 Marks)**

### Answer

#### **(a) Expenditure Incurred for Promotion of a Product:**

- (i) The expenditure incurred for promotion of a new or existing product may entail future benefits. It may be like advertisement in the papers, television, sales exhibition, participation in trade fair, issue of promotional pamphlets, free gifts etc.
- (ii) The auditor should vouch the authority and accuracy of the transactions. He should read the contract with advertisement agencies, promotional policies decided by the management from the board minutes etc.
- (iii) He should check the amounts paid to the agencies from bank book. He should check the accuracy. He should ascertain whether tax had been deducted in accordance with the tax law provisions if any applicable in this regard.
- (iv) He should check whether the unpaid amounts and accrued liability towards promotional advertisement contracts had been duly provided for in the accounts.

- (v) The huge expenditure should not be treated as deferred revenue expenditure. According to AS 26, these are not intangible assets that may be carried over the periods of accounting. These must be expensed with in the year in which these arise.
- (b) Inventories – Work-in-progress:** The auditor may involve a technical expert in verification of work-in-progress if necessary. He may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date, particularly of items the production of which have been abandoned and for items the manufacture of which is not being actively undertaken provided cost sheets are available in respect of individual items or lots of jobs or work orders, which cannot be identified with physical work, these should be verified as follows:
  - (i) Ascertain that the cost sheets are duly attested by the Works Engineer and Works Manager.
  - (ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost-sheets by reference to the records maintained in respect of issues of materials, payment of wages and its classification and original evidence in respect of all expenditure included in the cost-sheets.
  - (iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimate of cost expected to be maintained under actual operating conditions during a limited future period (wherever these have been developed).
  - (iv) Ensure that the allocation of overhead expenses has been made on reasonable basis and that total of the overhead expenses does not include any amount in respect of selling distribution and office expenses.
  - (v) Compare the cost-sheet in detail with that of the previous year both in regard to the composition of cost and the value placed on various components. If they vary materially, investigate the causes thereof.
- (c) Purchase Return:**
  - (i) Examine debit note issued to the supplier which in turn may be confirmed by corresponding credit note issued by the supplier acknowledging the same. The relevant correspondence may also be examined.
  - (ii) Verify by reference to relevant corresponding record in good outward book or the stores records. Further, the figures in this documentary evidence should be compared with the supplier's original invoices for rates and other charges and calculation should also be checked.
  - (iii) Examine in depth to eliminate the possibility of fictitious purchase returns for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.

- (iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

**(d) Discounted Bill Receivable Dishonoured:**

- (i) Obtain the schedule of discounted bills receivable dishonoured.
- (ii) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.
- (iii) Verify the bills receivable returned by the bank along with bank's advice.
- (iv) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the trade receivable is also debited.
- (v) Check that bank commission, if any, charged by the bank has been recovered from the party.

**Question 4**

Answer **all** questions:

- (a) *In the context of SA-315, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit.*  
**(4 Marks)**
- (b) *A person shall not be eligible for appointment as an auditor of a company where subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting and specialized services as provided in Sec.144. Explain.*  
**(6 Marks)**
- (c) *What steps would you take into consideration in auditing the receipts from patients of a Hospital?*  
**(6 Marks)**

**Answer**

- (a) Assertions used by the auditor to consider the different types of potential misstatements that may occur with respect to classes of transactions and events for the period under audit:
  - (i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.
  - (ii) Completeness—all transactions and events that should have been recorded have been recorded.
  - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
  - (iv) Cut-off—transactions and events have been recorded in the correct accounting period.



- (v) Classification—transactions and events have been recorded in the proper accounts.
- (b) Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 (hereinafter referred as CAAR), the following person shall not be eligible for appointment as an auditor of a company, namely-

any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

**Section 144 of the Companies Act, 2013 is a new provision** which prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- (i) accounting and book keeping services;
  - (ii) internal audit;
  - (iii) design and implementation of any financial information system;
  - (iv) actuarial services;
  - (v) investment advisory services;
  - (vi) investment banking services;
  - (vii) rendering of outsourced financial services;
  - (viii) management services; and
  - (ix) any other kind of services as may be prescribed.
- (c) **Auditing the Receipts from Patients of a Hospital: Following are the steps to be considered -**
- (i) Examine the internal check system as regards the receipts of bills from the patients.
  - (ii) Vouch the register of patients with copy of bills issued to them.
  - (iii) Verify bills for a selected period with the patient's attendance record to see that the bills have been correctly prepared.
  - (iv) See that bills have been issued to all the patients according to the rules of the hospital.
  - (v) Check cash collections as entered in the cash book with the receipts, counterfoils and other evidence.
  - (vi) Compare the total income with the amount budgeted for the same and report to the management for significant variations which have been taken place.

**Question 5**

Answer *all* questions:

- (a) *Discuss the need of CAATs in a CIS environment.* (4 Marks)
- (b) *'Knowledge of Client business' is one of the important principles in developing an overall audit plan. Explain.* (6 Marks)
- (c) *Is detection of fraud and error duty of an auditor?* (6 Marks)

**Answer**

- (a) **Need of CAATs in a CIS Environment:** Computer Assisted audit techniques (CAATs) may be required in a CIS environment in the following circumstances-

- ◆ The absence of input documents (e.g. order entry in on-line systems) or the generation of accounting transactions by computer programs (e.g. automatic calculation of discounts) may preclude the auditor from examining documentary evidence.
- ◆ The lack of a visible audit trail will preclude the auditor from visually following transactions through the computerized accounting system.
- ◆ The lack of visible output may necessitate access to data retained on files readable only by the computer.

The effectiveness and efficiency of auditing procedures may be improved through the use of computer-assisted audit techniques in obtaining and evaluating audit evidence, for example:

- (i) Some transactions may be tested more effectively for a similar level of cost by using the computer to examine all or a greater number of transactions than would otherwise be selected.
  - (ii) In applying analytical review procedures, transactions or balance details may be reviewed and reports printed of unusual items more efficiently by using the computer than by manual methods.
- (b) **Knowledge of the Client's Business:** It is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment" the auditor shall obtain an understanding of the following:
- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework.
  - (b) The nature of the entity, including:
    - (i) its operations;

- (ii) its ownership and governance structures;
  - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
  - (iv) the way that the entity is structured and how it is financed;
- to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
  - (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
  - (e) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgements regarding the appropriateness of accounting policies and disclosures.

- (c) **Detection of Fraud and Error - Duty of an Auditor:** As per SA-240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. In exercising oversight responsibility, those charged with governance consider the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability. Broadly, the general principles laid down in this regard are:
  - (i) An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. As described in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial

statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.

- (ii) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.
- (iii) Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.
- (iv) When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

It may be concluded from the above that detection of fraud and error is not the duty of the auditor provided that he complies with the requirements given in Standards on Auditing, maintains professional scepticism throughout the audit and is not grossly negligent in the performance of his duties as an auditor.

#### Question 6

Answer **all** questions:

- (a) State various factors that help the auditor to ascertain as to what is sufficient and appropriate audit evidence. **(4 Marks)**
- (b) Prior approval of the company by a special resolution is required for entering into transaction(s) with any related party. Discuss. **(6 Marks)**
- (c) Explain different connotation of 'Cost' in terms of inventories. **(6 Marks)**

#### Answer

- (a) **Factors which influence auditor's judgement:** The various factors which may influence the auditor's judgment as to what is sufficient and appropriate audit evidence are as under:
  - (i) Degree of risk of misstatements which may be affected by factors such as the nature of items, adequacy of internal control, nature and size of businesses carried

out by the entity, situations which may exert an unusual influence on management and the financial position of the entity.

- (ii) The materiality of the item.
  - (iii) The experience gained during previous audits.
  - (iv) The results of auditing procedures, including fraud and errors which may have been found.
  - (v) The type of information available.
  - (vi) The trend indicated by accounting ratios and analysis.
- (b) **Special resolution for entering into transaction(s) with any related party:** Prior approval of the company by a special resolution is required for entering into transaction(s) with any related party, where transaction(s) to be entered into:-
- (a) are contracts or arrangements, with criteria as mentioned below-
    - (i) sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 10% of the turnover of the company or ₹ 100 crore, whichever is lower;
    - (ii) selling or otherwise disposing of or buying property of any kind, directly or through appointment of agents, exceeding 10% of net worth of the company or ₹ 100 crore, whichever is lower;
    - (iii) leasing of property of any kind exceeding 10% of the net worth of the company or 10% of turnover of the company or ₹ 100 crore, whichever is lower;
    - (iv) availing or rendering of any services directly or through appointment of agents exceeding 10% of the turnover of the company or ₹ 50 crore, whichever is lower;
- It may be noted that the limits specified above shall apply for transaction(s) to be entered into either individually or taken together with the previous transactions during a financial year.
- (b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding ₹ 2.5 lakh;
  - (c) is for remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth.
- (c) **Different connotations of 'Cost':** The significance of this term varies in different circumstances on account of the nature of goods and the methods by which cost has been computed. Essentially, it refers to an appropriate combination of the cost of purchase, cost of conversion and other costs incurred in the normal course of business in bringing the inventories up to the present location and condition.

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- (a) abnormal amounts of wasted materials, labour, or other production costs;
- (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (d) selling and distribution costs.

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

The cost of inventories, other than those dealt with in paragraph 14 of AS-2, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

#### Question 7

Write short notes on **any four** of the following:

- (a) Propriety audit
- (b) Narrative record
- (c) Responsibility of Joint Auditors
- (d) Applicable financial reporting framework
- (e) Haphazard sampling.

**(4 x 4 = 16 Marks)**

#### Answer

- (a) **Propriety Audits:** The Propriety audit is to vet the expenditure in the annals of financial wisdom and uprightness. It is to check to bring out the improper, avoidable, or infructuous expenditure even though such expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit in so far as the various formalities regarding rules and regulations are concerned but may still be highly wasteful. It is not audit of sanction or against norms. It is a qualitative, opinion-based expression of auditor's findings as regards the efficiency, effectiveness and economy dimensions of expenditure.

In this regards, the following main points should be kept for consideration:

- (1) The expenditure should not be prima facie more than what the occasion demands. Public money should be spent by the officers as of his own with utmost diligence and care.

- (2) No order for sanction of expenditure should be made by an authority which results in pecuniary gains directly or indirectly.
  - (3) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
    - (i) the amount of expenditure involved is insignificant; or
    - (ii) a claim for the amount could be enforced in a Court of law; or
    - (iii) the expenditure is in pursuance of a recognised policy or custom; and
    - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.
  - (4) There should not be profiteering by the authority or anybody where the expenditure is in the nature of compensating.
  - (5) Wastages are avoided in expenditure. The cost of administering should not eat off the benefits of the expenditure.
  - (6) The expenditure should percolate down the beneficiary without corruption.
  - (7) The expenditure should bring out optimum, enduring benefits instead of mere frittering away the public money on meeting day to day needs repeatedly.
- (b) **The Narrative Record:** This is a complete and exhaustive description of the system as found in operation by the auditor. Actual testing and observation are necessary before such a record can be developed. It may be recommended in cases where no formal control system is in operation and would be more suited to small business. The basic disadvantages of narrative records are:
- (i) To comprehend the system in operation is quite difficult.
  - (ii) To identify weaknesses or gaps in the system.
  - (iii) To incorporate changes arising on account of reshuffling of manpower, etc.
- (c) **Responsibilities of Joint Auditors:** As per SA 299, in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him. In respect of other works, which are not divided, all joint auditors are jointly and severally responsible for:
- (i) Audit work which is not divided and is carried on jointly by all the joint auditors
  - (ii) Decision taken by all joint auditors concerning the nature, timing or extent of audit procedures to be performed by any of the joint auditors.
  - (iii) Matters which are brought to the notice of joint auditors by any one of them and on which there is agreement among the joint auditors

- (iv) Examining the financial statements of the entity comply with the disclosure requirements of the relevant statute
- (v) Ensuring that the audit report complies with the requirement of the relevant statute

**(d) Applicable financial reporting framework** – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The applicable financial reporting framework often encompasses financial reporting standards established by an authorised or recognised standards setting organisation, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorised or recognised standards setting organisation and legislative or regulatory requirements.

**(e) Haphazard sampling:**

- (i) Haphazard selection, in which the auditor selects the sample without following a structured technique.
- (ii) Though no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page)
- (iii) attempt to ensure that all items in the population have a chance of selection.
- (iv) Haphazard selection is not appropriate when using statistical sampling.